Metals Industry

Hilco Perspectives

Your Single Source for Industry Updates and Asset Valuation Trends

JUNE 2011

RECENT APPRAISAL & LIQUIDATION EXPERIENCE

Tube City, LLC

PTC Alliance

Metals USA

Neenah Foundry

Douglas Steel

Midwest Pipe & Steel

Racer Transmission

Machining Specialists, Inc.

Smartparts

RECOVERY FACTORS

>> Overall state of industrial manufacturing

>> Demand throughout transportation and construction industries

>> Lead times for new equipment

>> Supply of used equipment in the marketplace

>> Willingness of companies to invest capital

>> Cost of raw materials

M&E Update

Industry Outlook for Used Equipment

By John Magnuson

Scrap Processing

It is often said that the market for scrap processing machinery follows the market for scrap metals. The roller coaster ride of ferrous and non-ferrous scrap prices over the past two years seems to have ended. The market has settled at prices that are high based on those of the last 10 years, but still 20% less than the historic highs of 2008.

Forecasts for the scrap markets market are mixed. One report in American Metal Market stated, "Ferrous scrap offers into Southeast Asia have narrowed and are poised to fall in the coming weeks as weak demand persists." Another report, published a few days before, suggested, "The ferrous scrap market faces short supply and sharp price hikes in the next three months if China buys in big volumes." A third report stated, "China already has entered the U.S. East Coast ferrous market to replenish stocks, and could drive a shortage of scrap and a boom in U.S. export offers".

For scrap metals processing machinery, good late model equipment is becomming hard to find. Used equipment dealers report that only older scrap balers, shears, shredders, and separating systems are readily available. Late-model material handling cranes and loaders also are in short supply, and prices are stabilizing or rising due to an increase in demand. With most scrap processors now operating in the black, many seek to upgrade equipment or make purchases that had been put off for a few years; however, they are finding it difficult to locate good used equipment to fill those needs.

For now, the prospects for the used equipment market in this industry are good, but the scrap metals markets bear watching. If that market falters, equipment values could follow.

> ***"For now, the prospects for the used equipment market in this industry are good."***

Metal Fabrication

The vast amount of surplus equipment that once flooded the used marketplace during the last two years of the recession has diminished greatly. Machinery and equipment that was unsalable or worth only its scrap value 12 months earlier now is in demand.

End-user attendance and bidding activity has increased significantly at auction sales. Used machinery dealers are finding it difficult to purchase quality inventory as they try to compete with end-users that aggressively are purchasing

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M&E Update *(continued)*

through all available means. In addition, industrial machinery shipments increased 13.6% in November 2010, while orders for new machinery increased slightly. Consequently, the industry has witnessed a dramatic increase in the recovery values of select assets and asset types in recent months.

CNC Metalworking

The global recession squeezed demand conditions in downstream markets both domestically and abroad, such as automobile production and the construction sectors. This drastically affected the used computer numerical-controlled (CNC) sales. The market had, as some in the industry have called it, a "cleansing of the market," meaning all old used CNC equipment on the market was sold at below-market values or simply scrapped.

Currently, the used CNC market is void of good quality equipment available to buyers. Without availability, the supply and demand theory is in play. Limited equipment on the open market has increased prices and buyers are lining themselves up with used equipment dealers around the country, putting in standing orders for particular CNC equipment to fit their production needs.

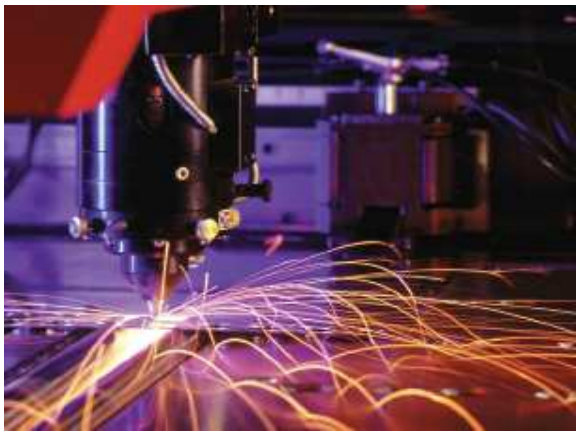
Another factor affecting the used CNC market is the delivery of new CNC machines. New delivery on larger horizontal machining centers, vertical machining centers, and boring mills is out six to eight months delivery time. Commodity-type equipment (e.g., 2-axis turning and smaller machining centers, such as 30- by 16- and 40- x 20 -inch verticals and 400- to 500-millimeter horizontal machines) are out two to four months delivery from most original equipment manufacturers.

For now, the used CNC market is looking up after a few very difficult years.

Wire and Cable

In general, wire equipment can be divided into ferrous and non-ferrous processing machines. Both types of equipment perform the same basic operations to produce specific wire products, but most equipment is exclusive to its respective industry. Some non-ferrous wire applications include electrical infrastructure power transmission, commercial and residential electrical power distribution, cable networks, and telecommunications. A few ferrous wire applications include national infrastructure construction; residential and commercial construction; light-to-heavy car and truck manufacturing; and farm, lawn, and garden manufacturing.

According to a recent report published by IBISWorld concerning the non-ferrous wire industry, the availability of up-to-date and efficient energy and communications infrastructure and equipment drives demand for cable and wire. Over the past few years, however, demand has fluctuated due to adverse economic conditions and dramatic declines in building activity, corporate investment, and industrial activity in the U.S.



Late-model, high-quality non-ferrous wire production equipment rarely becomes available on the used market in any real quantity. When it does become available, it tends to command a premium. Other driving factors making newer late-model equipment more attractive is the inherent high cost and long lead times for new equipment. Overall, the current used copper and aluminum wire machinery market has seen a slight upswing and stabilization over recent years' depressed values. Accordingly, the industry as a whole has experienced overall consolidation and equalization in production capacity.

According to another report published by IBISWorld concerning the ferrous wire industry, recovery is on the horizon. After several consecutive quarters of declining revenue, the industry is expected to show signs of growth in the near future throughout 2011, and growth rates finally will return to levels comparable to those prior to the recession.

The trend for used ferrous wire equipment ostensibly follows other more commodity markets for used metalworking equipment, such as machine tools or fabricating equipment. The recent global recession had taken its toll on the values of wire equipment, are signs that values are returning to more respectable levels. The value for used wire equipment is following suit with the more commodity-type equipment markets where there is a limited amount of quality equipment available, hence driving up the value. Older-model equipment values have remained stable, both domestically and abroad.

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Inventory Update

Stainless Foresees Increased Demand

By Michael P. Sullivan

Stainless steel products – including plate, sheet, coiled products, bars, and shapes — typically are sold through distribution centers (DCs) that purchase in bulk from major mills and redistribute to fabricators. Stainless products are sold using a base price that typically changes slowly over time, as well as an alloy surcharge which changes monthly. The surcharge is based on the quantity of each alloy used and their respective cost.

The majority of stainless products fall into the 300 or 400 series (also referred to austenitic stainless and ferritic stainless, respectively). The 400 series grades primarily are alloyed with varying amounts of chrome, while the 300 series are primarily alloyed with chrome and nickel. The high cost of nickel makes the 300 series significantly more expensive than the 400 series. Common grades in the industry include American Iron and Steel Institute (AISI) 304, 314, 409, 410, and 430.

The 300 series grades typically are used in food preparation and processing, chemical processing, and marine applications; the 400 series grades are used in automotive exhausts, automotive trim, and other less-demanding applications.

There has been an extended period of increasing surcharges in the U.S. market driven mainly by changes in nickel pricing. Higher surcharges led to higher transaction prices.

Moderation in the cost of some alloys is expected to bring lower alloy surcharges. While surcharges are expected to moderate, the producing mills have announced increases in base prices to maintain current transaction prices.

> ***"Demand for stainless products continues to increase as the U.S. economy slowly expands."***

Like other metals, the demand for stainless products continues to increase as the U.S. economy slowly expands.

DCs remain wary of falling transaction and surcharge prices from mills, as this lowers the value of inventory. Distributors are carrying inventory representing approximately three months of shipments.

Thyssen Krupp announced that it is considering alternatives that would separate its stainless and carbon steel operations. This strategic decision may mirror that of ArcelorMittal, which spun off its stainless operations in Europe and Brazil to form Aperam. Aperam has operations in 30 countries (Hilco performed the inventory appraisal that was a key factor in the successful spinoff).

The rapidly changing landscape in stainless could lead to increased price competition among newly independent companies. Conversely, the separation of stainless operations could pave the way for consolidation of stainless producers, leading to less competition and higher prices.

PRIMARY RECOVERY FACTORS

>> The market price trend has been upward due to increases in base prices and surcharges. Increasing market prices usually lead to increased gross orderly liquidation values (GOLVs), as the average cost of inventory may be lower than current market prices.

>> Distributors of plate products typically have large inventories of remnants left over from plate sawing operations. Typically, these are carried in inventory at the original purchase cost or the average purchase cost. In the event of a sale, remnants likely would have lower recovery values than full plates. Any appraisal should identify remnant inventory in plate and other inventory types and recognize its lower recovery values.

Michael P. Sullivan is Vice President and Lead Appraiser for the Metals Inventory Specialty Practice. Michael has more than 20 years of metals industry experience, including product development, toll processing, cold rolled strip steel, scheduling, and inventory control. He has an MBA in logistics, inventory control, and operations from Michigan State University, and a bachelor's degree in civil engineering from the University of Detroit.

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Inventory Update *(continued)*

Carbon Steel Demand Remains Strong

By Michael P. Sullivan

PRIMARY RECOVERY FACTORS

>> Market price increased rapidly in the last six month on most finished steel products. The six-to-eight-week lag between order placement with producing mills and delivery means that the average cost of inventories at most metals companies remains below current market prices, and GOLVs generally are increasing.

>> Real consumption remains limited, while supply has increased, as the mills expand output and bring idled or new capacity on line leading to downward pressure on prices in May 2011. After six months of increases, the mills finally announced price decreases. Decreases in market prices typically lead to lower GOLVs.

>> Inventories remain low as service centers, distributors, and steel users remain wary. Low inventories in the industry as a whole generally support higher recovery values in the event of a Sale.

In our first quarter perspective, Hilco reviewed the cost and market drivers that had led to a series of price increases in the fourth quarter of 2010 and the first quarter of 2011. Carbon steel prices primarily are driven by supply and demand, as well as changes in the prices of the major steel-making raw materials, such as iron ore, coke steel scrap, and energy.

The mills announced a series of price increases on most finished steel products beginning in November 2008 and continuing throughout the first four months of 2011. Prices on hot-rolled coil increased from approximately $520 per ton in mid-November 2010 to approximately $880 per ton in April 2011. While most steel products increased in price, increases in prices for rebar and other construction-related products were less dramatic.

Demand for certain market segments – including flatroll, special bar quality products, seamless tubes, and certain welded tubes – remains strong and supplies short, while demand for certain long products and structurals remains modest.

In May 2011, after nearly six months of increasing prices, various mills announced price decreases brought about by changes in demand, changes in input cost, and an increase in supply as mills expanded capacity by bringing idled facilities back on line and expanding output from those facilities already running.

Inventories throughout the distribution chain remain low, and the Metals Service Center Institute estimates that the service center industry is holding a seasonally adjusted inventory representing approximately 2.4 months of shipments.

Having seen market prices peak and then collapse in 2008, steel users have become inventory risk averse and are purchasing steel on a replacement basis, rather than building inventory. Buyers remain cautious, uncertain whether May is a short-term lull or a signal of further decreases in pricing.

The unwillingness to hold inventory means that the industry continues to operate on a hand-to-mouth basis, with companies purchasing only enough steel to supply current customers and demand. While this method minimizes inventory risk, it also subjects the industry to increased volatility, as there is little room to expand or contract inventory in response to changes in market pricing.

Looking back to 2008, the second half of 2011 may be a period of falling market prices when the average cost of inventory on hand is greater than mill replacement cost, resulting in lower GOLVs. Lenders should remain diligent in understanding changes in market prices and be aware that the high GOLVs seen early in 2011 may not accurately represent recovery values in the coming fourth quarter 2011.